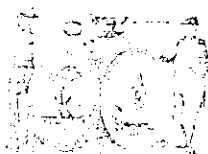


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(803) 734-3793

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March 19, 1991

The Honorable Nikki G. Setzler  
412 Gressette Bldg.  
Columbia, SC 29202

Dear Senator Setzler:

The House of Representatives passed a proviso in Part I of the Appropriations Bill that revises the method that the Division of Research uses to calculate the EFA inflation factor. The proviso adopts the procedure that the Division recommended to the Committee to Study Formula Funding last July. Although we gave considerable detail on the proposed methodology to the Committee to Study Formula Funding, I thought it might be helpful to your Subcommittee if we spelled out in a little more detail the procedure for calculating the factor that we proposed. I have, therefore, attached a short paper that shows the calculation that would be used if the proviso were adopted by the General Assembly.

Let me emphasize that the Division has not recommended including the revised factor in this year's Bill because it was our understanding that our research was only part of a full review of the EFA. Nonetheless, we do feel that the revised procedure would be an improvement over the current method. If I can answer any questions, please let me know.

Sincerely,

A handwritten signature in cursive script that reads "William Gillespie".

William Gillespie, PH. D.

WCG/rt

A NEW METHOD FOR COMPUTING THE INFLATION FACTOR FOR  
THE EDUCATION FINANCE ACT

March 20, 1991

OFFICE OF ECONOMIC RESEARCH  
DIVISION OF RESEARCH

## INTRODUCTION

The Education Finance Act (EFA) requires that the Division of Research estimate a factor to account for inflation in basic education funding. Beginning in FY 1978-1979, the Division projected the EFA factor based on compensation of state and local government employees nationwide along with an index of purchases of goods and materials by state and local governments. After an extensive review of the methodology, the Division found strong sentiment among members of the General Assembly to base the factor on regional, rather than national wages. The Division also determined that fringe benefits, which were part of compensation, were having a greater impact on the factor than originally anticipated and should be excluded from the inflation factor.

Consequently, the Division recommended to the Committee to Study Formula in July 1990 that the salary component of the factor be increased by the same rate as school wages in the Southeast. Not only would this methodology base wage funding for the EFA on wages of school employees in the Southeast, but would also exclude fringe benefits from the factor.

## CALCULATION OF SOUTHEASTERN WAGES

The Division surveyed the southeastern states and found that the Employment and Security Commissions of the various states could provide data on wages and the number of employees in primary and secondary public schools. This information is collected quarterly from the school districts under the Workers Compensation Program. Most states publish wages for school employees separately, but some don't. All states, however, have been willing to provide the Division data on public school wages, even if they don't publish the figures.

The Division calculates a simple average wage of all employees in the Southeast by summing the total wages paid to all employees and dividing by the number of employees in the Southeast. For fiscal year 1989-1990, which is the latest data currently available, the average wage of school employees in the Southeast was \$20,026, compared to \$21,054 for public school employees in South Carolina. The ratio of the average in South Carolina to the Southeast was 1.05. This new methodology maintains that same ratio so that its adoption would not impact the state's relative position compared to the Southeast.

## PROJECTING SOUTHEASTERN WAGES

To project the southeastern average wage for school employees, the Division surveys the states to obtain data on raises in teacher salaries, revenue trends, and trends in wages of non-teaching staff. The Division makes a projection of both the average teacher salary and non-teacher salary in each state.

The following table shows the calculation of the EFA wage factor. The projected average southeastern wage for FY 91-92 is \$21,896. To maintain the five percent differential, the average wage in South Carolina would have to be \$22,991, which is 9.2 percent above the actual average wage in South Carolina of \$21,054 in FY 89-90, the latest period of actual data. Because the State funded the EFA at 4.9 percent in FY 90-91, it would need to fund the wage portion of the EFA factor an additional 4.3 percent in FY 91-92 to give the school districts enough funds to maintain average wages in basic programs at the southeastern average.

# DETERMINATION OF WAGE PORTION OF EFA FACTOR

	Fiscal Year	Southeast Wage	SC Wage	Cumulative Percent Increase %	EFA Funded Increase %
Actual	89-90	20,026	21,054		
Projected	90-91	21,055	22,087 *	4.9	4.9
Projected	91-92	21,896	22,991 **	9.2	4.3

\* Computed as the same increase in EFA funding.

\*\* Computed as 1.05 times the southeast average wage.

Source: Office of Economic Research

Combining this wage increase with the projected increase for non-wages in the EFA factor, the EFA inflation factor for FY 91-92 is 4.2 percent.

## SELF CORRECTING MECHANISM

Under the current methodology, there is no mechanism for correcting any forecast error that might occur. This new methodology would correct for forecast errors by basing all increases to actual wages on the level in FY 89-90. Increases in the EFA factor needed to match the southeastern average wage would be measured from the FY 89-90 base, which for FY 91-92 is 9.2 percent. The amount of increase already funded would be subtracted from the

cumulative increase in the southeastern average wage. Because 4.9 percent was funded in FY 90-91, only 4.3 percent would be needed in FY 91-92 to match the full 9.2 percent increase. By this procedure, the factor would always be computed to match the southeastern average wage, regardless of any possible errors in previous years.